

DEALER TERMINATION CHECKLIST:

A PRACTICAL GUIDE

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July 2002

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Terminating existing dealers is often a necessary or desirable step to achieving important commercial objectives of a manufacturer, such as (1) substituting effective dealers for less productive ones, (2) consolidating the distribution function in fewer hands that enjoy the efficiencies of scale needed to improve market penetration, or (3) assuming for itself the distribution function in certain geographic regions or for particular classes of customers.

Unless the parting is something also desired by the dealer, a termination may prompt a dealer to search for any recourse to reverse the manufacturer's decision, including filing a lawsuit. Especially if the termination portends significant business losses, the dealer may be tempted to sue now and answer later any hard questions about the merits of its lawsuit. The aim of this checklist is to help manufacturers accomplish such terminations while, at the same time, minimizing the risk of expensive litigation.

Although the purposes of terminated dealers' lawsuits have not changed in the last 25 years, the nature of their legal claims has, and, in general, those suits have become more difficult for dealers to win. Although antitrust claims were once a popular vehicle for dealers to challenge a termination, such claims have been in decline ever since a pair of Supreme Court decisions established that a manufacturer's non-price restrictions on its dealers are almost presumptively legal under the federal antitrust laws. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977); Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988).

Terminated dealers have not, however, stopped suing their suppliers, nor has all risk of potential antitrust liability been eliminated. Particularly if the manufacturer has terminated the

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dealer under pressure from two or more of the dealer's competitors, or the manufacturer has been giving the terminated dealer less favorable pricing or promotional allowances than its competitors, the risk of antitrust liability can be significant. Absent those circumstances, however, terminated dealers have generally been forced to shift away from claims under the federal antitrust laws, and assert, instead, tort claims, claims for breach of actual or implied contract, and, in some jurisdictions, claims under state dealer and/or franchisee protection statutes. Few states have statutes protective of dealers in all industries, though many have laws that accord special protection to dealers in selected industries, such as automobiles, petroleum and farm machinery. Further, some businesses that would generally be thought of as "dealers" also have characteristics of "franchises" and thus may fall within the coverage of a few expansive state franchise laws.

With the assistance of counsel, and by carefully executing a step-by-step plan, a manufacturer can, nevertheless, substantially reduce the risks associated with terminating a dealer, no matter the legal theory selected by the dealer's lawyer.

Those precautionary steps are several, and include the following:

STEP ONE: Assessing the Risk of Litigation

- *What Is The Dealer's Reaction Likely To Be?*

Before embarking on an analysis of any agreements or laws that might govern when and how the dealer may be terminated, the manufacturer first ought to assess the likely reaction of the dealer, including the possibility of his filing a lawsuit, irrespective of its merit. The defense of even meritless lawsuits can be expensive and distracting, and thus the history and temperament of the dealer ought to be considered when choosing a course of action. The key question here is, in short, whether this dealer is the sort of person who is likely to sue first and

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contemplate the strength of that suit later (if ever). The answer to that threshold question will heavily influence the selection of the proper strategy for carrying out that termination.

- *Earmarks of a Dealer Who Is Likely To File Suit Upon Termination*

Predicting which dealers may sue if terminated is hazardous work, however, there are some characteristics of dealers who choose to sue their suppliers that echo throughout these types of cases. A manufacturer should be on the lookout for trouble from any one of the following types of dealers:

- a dealer who owes the manufacturer a large sum that the manufacturer insists upon collecting;
- a dealer whose product line consists entirely or principally of the manufacturer's product;
- a dealer who has large amounts of the manufacturer's product in inventory, and the dealer either does not wish to resell it or is not allowed by the manufacturer to do so;
- a dealer who has made large investments in its facility either at the manufacturer's request or exclusively for that manufacturer's benefit, and the benefits of those investments are not easily transferable to the dealer's future work on behalf of another manufacturer;
- a dealer who is near or at retirement age, and thus has less concern for obtaining a long-term reputation as a difficult or unreasonable reseller than he has for securing a possible retirement annuity by filing a lawsuit and possibly collecting a settlement or judgment in his favor;
- a dealer who has had a history of contentious relations with the manufacturer and who thus is unlikely to leave the scene without a fight, especially when the stakes are highest;
- a dealer who believes, correctly or not, that his efforts are responsible for the success of the manufacturer's product in his territory, that the manufacturer is trying to expropriate for itself the goodwill the dealer believes he has established for the product, and/or he is on the verge of securing some especially significant sales that the termination now jeopardizes;

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- a dealer who suspects, correctly or not, that his termination results from his price-cutting, and that it has come at the urging of higher-priced, competing resellers;
- a dealer who has paid higher prices for the manufacturer's product than the dealer's competitors have paid, and thus there may exist some basis for a price discrimination claim against the manufacturer under the Robinson-Patman Act; or
- a dealer who has agreed in the past with the manufacturer on the dealer's resale prices to its customers, and thus there may be a basis for a Section 1 Sherman Act claim against the manufacturer.
- a dealer in an industry with few, if any, replacement suppliers.
- *Involving Counsel at an Early Stage*

The presence of one or more of those factors will complicate the decisions of whether, when and how to terminate the dealer. It is, therefore, all the more important to involve counsel at an early stage of the deliberations, so that strategies to minimize the force of any of those factors can be implemented. For example, careful planning may allow the manufacturer to reduce its risk of suit by offering to buy back inventory, extend the minimum notice period, or forgive some indebtedness in exchange for a release of all claims by the dealer. Where the risk of a lawsuit is great, a small concession made at the time of the termination may later spare the manufacturer far more in litigation costs.

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STEP TWO: Avoiding Missteps During The Termination Review Process

- *Maintaining Confidentiality and Crafting Internal and External Communications*

The success of a termination may depend in large measure on how the manufacturer behaves while it has the termination under consideration. All company employees who are aware of the review should be instructed to maintain its confidentiality, and should take particular care not to initiate any communications with the dealer's competitors about the possible termination.

The purposes of this restriction include ensuring that the dealer under review not be led to believe that the termination is going to happen, even though a final decision has not, in fact, been made. In the event of such a leak, the manufacturer may not be able to restore its relationship with its dealer should the termination not go forward. Moreover, that restriction limits the risk of communications between the manufacturer's employees and the dealer's competitors that could later be misconstrued as part of a conspiracy to have that particular dealer terminated. Such a conspiracy or agreement could give rise to liability under Section 1 of the Sherman Act.

Proof that competing dealers requested that a manufacturer terminate one of their competitors is not alone sufficient to sustain a claim that the manufacturer *agreed* with them on such a course of action. Nevertheless, it can provide one link in the chain of reasoning necessary to establish that such an agreement was reached, and that the antitrust laws were violated as a result.

Counsel should review and approve all communications between the manufacturer and the dealer during the termination review process (and thereafter, if the dealer is

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terminated), except for routine invoices. The aim of this precaution is to ensure that nothing is said which could be construed as some implied assurance that the parties' relationship shall continue. Likewise, this precaution helps ensure that nothing be said which could serve as fodder for a claim that the dealer was not treated even-handedly or in accordance with the dealer agreement while still serving as a dealer.

With the advice and assistance of counsel, the manufacturer should also consider preparing a contemporaneous internal record that would help establish in any court proceeding that the reason the dealer was given for his termination was not a pretext, and was, in fact, the actual basis for the termination.

Finally, all files reflecting the involvement and advice of counsel in the termination decision should bear a clear indication that they are privileged, and thus are protected from discovery to the extent the law allows.

- *Reviewing the Dealer Agreement*

If the manufacturer and dealer do have a written agreement, its procedures for carrying out a termination need to be followed (unless they happen to be contradicted by any state statute that may govern such terminations).

Oddly enough, one or both of the parties often mistakenly conclude that there is a distributor agreement, when, in fact, there is not. If, as is often the case, the parties have a document that describes the obligations each will undertake should they choose to do business with one another (e.g., prices, credit terms, etc.), but the document imposes no obligation on the dealer ever to buy anything from the manufacturer, that document probably is *not* an enforceable dealer agreement. What the manufacturer and dealer may believe is a dealer agreement is often merely a revocable offer by the manufacturer to sell.

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- *Do The Parties Have An “At Will” Relationship?*

If there is no written distributorship agreement in place, the parties’ prior communications need to be reviewed to determine whether there is any basis for a claim that there is an oral agreement or an implied agreement.

If no binding agreement of any sort is in place, the manufacturer and dealer are said to have an “at will” relationship that allows either party to terminate the relationship for any reason or no reason. Often, the only requirement that state law will impose is that the manufacturer give the dealer “reasonable notice.”

- *Reviewing The Applicable State Law*

Only a few states, e.g., Maryland, New Jersey and Wisconsin, have either a statute of general application that provides dealers in all industries with some protection from termination or an expansive state franchisee protection law that can encompass businesses that are generally thought of only as “dealers.” Most states have statutes that accord certain protections only to dealers in particular industries, such as automobiles, petroleum and heavy machinery. Therefore, depending upon the jurisdiction and the industry in question, there may be state legislation that limits the manufacturer’s freedom to terminate the dealer.

Wherever the dealer happens to be located, that state’s law must be reviewed to determine whether there is an applicable dealer termination statute and, if so, whether it contains procedural requirements or other obstacles to the termination that may supersede or supplement the terms of the parties’ contract.

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- *Is There a “Good Cause” Requirement?*

If the dealer agreement or an applicable state statute requires that there be “good cause” for the dealer’s termination, the manufacturer should gather and develop evidence of any shortcomings of the dealer that rise to the level of “good cause.”

Some of the more protective state statutes also require that the manufacturer provide the dealer with notice of those grounds for termination, give the dealer an opportunity to correct those shortcomings, and allow the termination to occur only if the dealer then fails to rectify the problem in the time allotted by the statute.

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STEP THREE: Notifying The Dealer

- *Providing Notice*

The manufacturer must scrupulously follow any minimum notice period for termination that may be prescribed either by a dealer agreement or any applicable state statute.

Even in the absence of any statutory or contractual requirement that notice be given, the manufacturer ought to take the precaution of affording the terminated dealer at least 30 to 60 days notice, if possible. Reasonable advance notice can help diminish dealer animosity and diminish a court's sympathy for the terminated dealer, should litigation result.

The notice should accurately state the grounds for termination. Providing pretextual reasons for the termination invites litigation.

- *Defusing The Momentum Toward Litigation*

In instances in which the dealer's business is largely dependent on resales of the manufacturer's products, or there are other circumstances which increase the sensitivity of the termination of a particular dealer, the *manner* in which the manufacturer delivers the notice can be as important as the message itself.

If the manufacturer has been conveying a growing dissatisfaction with the dealer's performance leading up to the notice of termination, the dealer is less likely to be surprised, and he may even have begun laying the groundwork for life without the manufacturer's product. Early warnings from the manufacturer diminish the possibility that the dealer will file suit against the manufacturer simply out of anger or as a knee-jerk response to having been terminated.

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When, however, there have been no warnings of what is to come, or they have been given but the dealer has ignored or misperceived them, the manufacturer ought to consider taking some additional steps at the time notice is given in order to soften the blow.

One alternative is to have two or more representatives of the manufacturer -- preferably people who have had a good relationship with the dealer -- meet with him in person, alert him that written notice of the termination will soon be forthcoming, truthfully explain why it is happening, and consider any of his reasonable proposals for minimizing the harm to his business that the termination will likely cause.

A human touch may not work in all circumstances, and the oral presentation needs to be carefully planned so that nothing is said by the manufacturer which could *increase* the risk of a successful lawsuit, such as misrepresenting why the termination is happening. (Because of this risk, more than one representative of the manufacturer ought to attend the meeting so that the manufacturer has multiple witnesses to what was actually said to the dealer.) Nevertheless, a visit by the manufacturer to the dealer, if properly scripted and handled, allows the parties to discuss mutually acceptable terms for a more amicable parting of the ways, reduces the chances of a suit being filed out of blind anger, and blunts an often powerful (if usually legally irrelevant) argument that the manufacturer inflicted greater harm on the dealer's business than it needed to by the way in which it handled the termination.

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STEP FOUR: Post-Termination Obligations and Precautions

- *Are Any Post-Termination Duties Owed by One Party To The Other?*

The parties' agreement or an applicable state statute may require the manufacturer to repurchase the dealer's inventory, reimburse it for recent capital improvements it has made at the request of or exclusively for the benefit of the manufacturer, or take other actions to compensate the dealer upon termination. Those requirements must also be understood and followed.

Indeed, even if not required by contract or statute, the manufacturer ought to consider offering to repurchase any remaining inventory from the dealer. The manufacturer likely will not want a dealer that it has just terminated to continue representing its product -- a product for which the dealer presumably no longer has any enthusiasm. In addition, that offer deprives the dealer of an emotionally appealing argument that the manufacturer has acted in bad faith by terminating him after he has made a substantial, current investment that he may not be able to recoup.

Likewise, the parties' agreement may impose certain post-termination obligations on the *dealer*, such as the return of inventory for credit or ceasing the use of the manufacturer's trademark in the dealer's sales and advertising. The manufacturer should adhere to those provisions, as well, so that it is not vulnerable to a claim that it has waived the dealer's obligation to perform any such duties.

- *Assessing The Worth of a Suit To Recover Accounts Payable*

The manufacturer should carefully consider the wisdom of initiating any collection action for sums it is owed by the terminated dealer. Collection actions typically prompt the dealer to file a counterclaim based on the termination. Such counterclaims often

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assert breach of contract, tortious interference and price discrimination claims that can impose significant legal expenses on a manufacturer, irrespective of the claims' merit. Those expenses need to be weighed against the amount of the unpaid receivable, the likelihood that it can be collected, even if awarded, and the worth to the manufacturer of sending a message to other dealers that it will not allow large receivables to go unpaid.

That analysis changes completely, however, if the dealer has initiated suit first. In that event, the decision whether to sue for the unpaid balance is made for the manufacturer. Particularly if the dealer's failure to pay was a reason for his termination, a manufacturer's counterclaim to collect the unpaid account can be an extremely powerful antidote to any instinct the court may have to sympathize with the terminated dealer. Courts readily understand that manufacturers cannot reasonably be expected to continue selling their products to dealers who cannot or will not pay for them.

- *Controlling Communications Post-Termination*

A terminated dealer may try to have conversations with several people within the manufacturer's organization, searching for a sympathetic ear to assist in responding to a termination notice. To avoid the risks associated with such communications, the manufacturer should consolidate all communications in one individual who should be responsible for a prompt response to all of the dealer's inquiries.

Furthermore, the manufacturer should avoid being drawn into discussions with the terminated dealer's customers, suppliers, sources of finance or competitors as to why the termination happened. While acknowledging that the questioner's curiosity is natural, the manufacturer should avoid any explanations that might later form the basis of a trade libel or defamation claim by the terminated dealer.